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DIRECTORATE OF INTELLIGENCE

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Poland: Hard Currency Payments Results In 1983,
Outlook For 1984Summary

Poland's financial situation and near-term prospects offer little basis for optimism about a recovery from the debt crisis. Warsaw earned a large trade surplus last year, but a decline in new loans left payment capacity unchanged. Western banks negotiated their third rescheduling agreement with Warsaw and received most of the \$2 billion in payments made by Warsaw. Arrears to Paris Club creditors, however, grew to more than \$7 billion after a second year without concluding rescheduling agreements. Western governments lifted their ban on rescheduling official debt, but the Poles showed little interest in reaching an agreement and seemed content with defacto debt relief. [redacted]

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Warsaw's balance-of-payments plan for 1984 includes two variants: the more realistic calls for an increased trade surplus and projects a further drop in new credits, resulting in no growth in payment capacity; a more optimistic variant projects \$2.5 billion in new credits and a corresponding boost in payment capacity. Although

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banks have accepted Warsaw's proposal for multi-year rescheduling, negotiations are likely to be delayed by disagreement about new money. We estimate that, after paying banks, Warsaw should have about \$1 billion for Paris Club creditors. This would satisfy the government creditors' demand that Poland become current on the 1981 agreement. The Poles' recent hard line with the Paris Club indicates that it will be difficult to engage Warsaw in serious negotiations, and even more difficult to conclude an agreement requiring a large initial net flow of payments from Warsaw.

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Developments in 1983

Warsaw made some progress in dealing with its financial problems in 1983. Although total payments capacity did not increase, Poland covered obligations under bank rescheduling agreements and --for the first time since 1980--paid all interest to banks in the same year it came due. More important, Poland earned a greater share of its payments capacity by running on a record payments surplus rather than relying on borrowed funds.

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In other respects, however, Poland's financial situation deteriorated further last year. The most serious problem was the failure to heal the rift with Western government creditors. A second year without debt relief meant that arrears to this group swelled to \$7.1 billion. New credits fell sharply from all sources while the withdrawal of short-term credit lines continued. Hard currency debt increased because Warsaw could not cover interest payments to governments.

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Current Account Surplus Above Target

Last year foreign trade recovered somewhat from the depressed levels of 1982, but still fell short of the 1981 level. The higher-than-planned trade surplus was generated by holding imports to the 1982 level (See Table 1). Exports increased 14 percent over the first nine months of 1982, which put Warsaw on track to meet its export target of \$5.6 billion. On a payments basis, the hard currency trade surplus through September was \$750 million, and in October the Poles raised the

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full-year projection to \$950 million. Another major bright spot was that Warsaw's success in the gap between the value of net exports and the receipts gained from net exports from \$1.11 billion in 1982 to \$237 million in the first six months of this year (See Appendix). [REDACTED]

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Preliminary figures provided [REDACTED] in October on services (excluding interest) and transfers showed that a \$500 million surplus was likely for the year. Combined with the trade surplus, this gave Poland a \$1.45 billion surplus on current account excluding interest--40 percent greater than planned. [REDACTED]

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Dwindling Credits, Partial Debt Relief

Credit availability continued to decline as credit lines extended before 1982 were nearly exhausted. Warsaw initially projected \$800 million in new credits for the year, but by October revised the projection to \$550 million. Trade credits from Iraq to finance oil imports and from China for meat imports accounted for about half of this amount. Polish projections exclude trade credits drawn under bank rescheduling agreements. The Poles drew \$178 million under the 1982 agreement, and the agreement last year with the banks yielded another \$147 million in short-term trade credits at the end of the year. [REDACTED]

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After six months of difficult negotiations, Poland and Western banks agreed on terms for debt relief on \$1.3 billion in principal due in 1983. The agreement rescheduled 95 percent of 1983 principal payments until 1988-1992, with the remaining 5

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[redacted]

percent due in January 1984. Interest due on original loan contracts--\$270 million--was paid in November and December. The banks agreed to relend to Poland 65 percent of the interest payments in the form of short-term trade credits to finance imports to supply Warsaw's export industries. This agreement differs from the one for 1982 in the following respects:

- the principal repayment schedule is graduated, beginning at 10 percent in 1988 and escalating to 40 percent in 1992;
- the interest rate margin of 1 7/8 percent over LIBOR is 1/8 percent greater than under the 1981 and 1982 agreements;
- the interest-recycling facility relends 65 percent of the interest payments--compared to 50 percent in 1982--and allows the Poles more flexibility in the types of products they can buy and where they can buy them.

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Western government creditors held out against rescheduling for much of the year despite impatience by neutral countries--Austria, Switzerland, and Sweden--and as well as by some of the Allies. In July, the Paris Club finally agreed in principle to negotiate debt relief, and a technical team visited Warsaw in October. The momentum fizzled in November, however, when Polish officials made their first appearance at the Paris Club in two years and asked for a comprehensive package including generous debt relief, new credits, and IMF membership. The creditors

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responded that IMF membership and new credits were outside the scope of the Paris Club, and that further debt relief could not be provided until Poland met obligations under the agreement for 1981. [REDACTED]

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Allocating Payment Capacity

We estimate that Poland's payment capacity for 1983 was \$2.4 billion, well above the Poles' original projection of \$1.9 billion. Warsaw continued to honor the agreements with the banks covering 1981 and 1982 debt, and it met payments due late in the year under the agreement for 1983. According to data available through September and estimates for the final three months, we estimate that Poland paid the banks about \$1.8 billion. Poland also paid some \$300 million to non-bank creditors. Apparently no payments were made to Paris Club creditors; we are unable to confirm a French press report that Poland paid Switzerland interest on the 1981 rescheduling agreement. [REDACTED]

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In sum, we estimate that of \$14.6 billion due to creditors in 1983, Poland paid just over \$2 billion, debt relief covered \$1.2 billion, and the remaining \$11 billion--largely to Western governments--were in arrears. [REDACTED]

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Outlook for 1984

The trends of the past two years--slow recovery of trade, difficult rescheduling negotiations, and dwindling credit availability--are likely to be repeated in 1984. While financial relations may be restored with government creditors, the

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immediate impact on Warsaw's financial situation probably would not be great.

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1984 Balance of Payments Plans

The balance of payments plan for 1984 (standard variant) calls for an increase in the trade surplus to \$1.3 billion. Exports and imports are to increase by 16 percent and 6 percent, respectively. The surplus on non-trade items is expected to fall to \$250 million from \$400 million in 1983, in part because of the need to grant credits to cover Polish exports. An alternative projection developed by Warsaw in late 1983 changed the assumption for credit drawings from \$200 million to \$2.5 billion, which would allow a substantial boost in exports and imports. The trade surplus, however, would increase by only \$100 million. Thus the earned payment capacity is virtually identical for either projection while the total payment capacity increases by \$2.35 billion under the high-credit version. The Poles consider this variant possible only if changes in "the political situation in the world" improve prospects for receiving credits, particularly from Western governments. Both plans should be considered preliminary and subject to final data on results for 1983.

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Huge Needs, Small Resources

We estimate that in 1984 Poland owes more than \$17 billion, two-thirds of which represents payments overdue from as long ago as 1981. Debt service due under original contracts will be

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sharply lower--\$5.7 billion compared to \$8 billion in 1983-- because amortization is declining and a greater share of interest payments is on rescheduled obligations. Our estimate of \$926 million due under rescheduling agreements is only slightly more than the total for 1983. [REDACTED]

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Poland's ability to pay will depend heavily on the level of new credits. The optimistic scenario for \$2.5 billion in new credits would yield a total payment capacity of \$4.1 billion-- sufficient to cover the payments that banks are likely to insist upon as well as to pay substantial sums to Paris Club creditors. If, on the other hand, new credits are only \$200 million, Poland would only be able to pay \$1.75 billion of debt service. [REDACTED]

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The poor outlook for large new credits makes it most unlikely that the \$2.5 billion in credits called for in the optimistic scenario will be available. At the same time, a senior Polish financial official acknowledged to the US Embassy in Warsaw, however, that the pessimistic assumption variant of \$200 million in new credits was deliberately understated, and that \$300-400 million is a more likely figure. We expect a similar amount of credits under a prospective 1984 agreement with the banks, which would boost total new credits to \$600-800 million. Our estimate of \$2.2-2.4 billion in total payment capacity is virtually the same as in 1983 but earned payment capacity will account for a greater share of the total than in 1983. [REDACTED]

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Prospects for Debt Relief

Negotiations on debt relief are certain to be contentious. Western banks and governments will press for terms tougher than Warsaw will accept, and both groups will vie for Poland's meager payment capacity. [REDACTED]

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Banks. After three years of rescheduling, roughly three-fourths of Warsaw's debt to Western banks has now been rescheduled. About \$600 million in principal is due in 1984, compared to \$2.3 billion in the peak year of 1982. Western banks, who rejected a Polish request for a multi-year rescheduling last year, are now willing to include all remaining unstructured debt in a single package to avoid further time-consuming negotiations. In the first few meetings in 1984, neither side offered proposals specific enough to begin negotiations. Banks wanted terms similar to the 1983 agreement, but could not agree on a mechanism for providing new credits. Polish officials emphasized that an agreement should restore Warsaw's access to trade credits. [REDACTED]

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In early February, Western banks agreed on terms that were then presented to the Poles at a 15 February meeting in Warsaw. The banks proposed:

- rescheduling 95 percent of all principal payments due after 1983 over eight years, including a grace period of five years;
- an interest rate of 1 7/8 percentage points over LIBOR on rescheduled obligations;
- payment in 1984 of the remaining 5 percent of principal

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and a 1-percent fee; and
-- payment in 1984 of interest on all of the debt to be
rescheduled. [REDACTED]

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Instead of recycling a percentage of the interest payments as short-term trade credits as under the 1982 and 1983 agreements, the banks proposed to provide \$150 million in a contingent facility to support letters of credit with each bank contributing in proportion to its exposure to Poland. The pool, managed by Dresdner Bank of West Germany, would be drawn upon only if Warsaw failed to cover a letter of credit. The size of this credit facility is a major sticking point. Polish officials rejected the banks' offer of the \$150 million pool. Warsaw wants an amount roughly equal to the short-term credit lines it had in 1981, which could be as high as \$1 billion. Poland's goal is to put its import financing on a more normal footing so that advance payments will not be necessary. Warsaw may object that the pool offers little or no new money because banks could use it to protect current short-term credit lines rather than to provide additional financing. Banks do not want to provide more than the value of interest payments due in 1984 on the \$1.9 billion in principal yet to be rescheduled--probably around \$200 million.

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[REDACTED]
The Poles are likely to press for lower interest rates and a longer repayment period. The bank proposal, for example, reschedules all principal repayments due in 1984 and subsequent years under a single repayment schedule. Statements by Polish

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officials indicate that Warsaw wants the repayment period to begin from the year the principal originally comes due, which would stretch out repayments over several additional years. []

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With negotiations at such an early stage and significant differences between the banks and Poles, it could take several months to conclude an agreement. The banks have already agreed among themselves on fallback positions on the interest rate and repayment period, but these probably will not satisfy Warsaw. Polish officials are under pressure to negotiate a favorable agreement. An open debate in the economic press in recent months indicates continued sensitivity on debt policy. Chairman Glazewski of Bank Handlowy (Poland's foreign trade bank) defended earlier agreements, while Deputy Chairman Dlugosz of the Planning Commission advocated terms which would minimize debt service payments. []

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At this point, there is little urgency about reaching a quick agreement. In each of the previous three reschedulings, the banks and Poles agreed on terms in August, and final signature of the accord came three to eight months later. []

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Paris Club. Although the West's ban on rescheduling Polish debt was lifted in late 1983, the standoff with government creditors continues. Arrears to the Paris Club creditors are climbing at the rate of more than \$200 million monthly, and Warsaw is well into its third year without debt rescheduling agreements. In reality, Warsaw has enjoyed de facto relief from making debt payments to its government creditors. []

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When it approved resumption of debt relief negotiations last July, the Paris Club served notice that restoring financial relations with Western governments will be slow and that, at least in the early stages, Poland will have to give more than it will get. The creditors held out no hope for new credits soon and agreed that Poland must cover obligations from 1981 before debt relief for 1982 can be concluded. In fact at a meeting last November, the Paris Club ordered the Poles to meet 1981 obligations by the end of 1983. Warsaw did not make the payments and informed some major creditors that none would be paid unless new credits are extended. The Poles refused to attend the next meeting in February, and several creditors considered offering a sweetened rescheduling deal to lure Warsaw to negotiate. [REDACTED]

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The Paris Club may well have considerable difficulty in engaging the Polish regime in serious negotiations. Creditors have little effective leverage. Default does not represent a viable threat, and most West European governments are anxious to lift the much milder economic sanctions now in place. On the other hand, extending sweeteners to lure Poland back to the table could frustrate attempts to establish a flow of net payments to the creditors. [REDACTED]

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Assuming that the Poles choose to resume negotiations, they are likely to request terms similar to as those presented to the banks last year--namely, rescheduling all debt service for up to 20 years. [REDACTED]

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[REDACTED] Poland needs \$6 to \$8 billion in new credits in the next three years. [REDACTED] approval of

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Warsaw's IMF application. The regime claims huge losses from Western sanctions and has indicated that it will seek correspondingly huge reparations as part of a rescheduling package. Warsaw apparently now believes that it has little to gain from resumed negotiations and little to lose from a continued stalemate. [REDACTED]

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Sharing the Money. If Poland covers the same categories of payments this year as it made in 1981-83, (about \$1.2 billion), or nearly one-half of its estimated payments capacity, will be paid to banks. Obligations under bank rescheduling agreements would require nearly \$700 million, and interest due to banks in 1984 and under original loan contracts--including short-term debt--would take another \$400 million. Another \$100 million would be added if the next bank rescheduling agreement calls for a downpayment of 5 percent of principal and a 1-percent rescheduling fee. [REDACTED]

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Assuming that a Paris Club agreement can be reached, creditors first will urge Poland to pay off unrescheduled obligations from 1981, and then to cover the interest due during 1982-1984 on rescheduled amounts. We estimate that catching up on these payments through 1984 would cost Poland about \$600 million. If the creditors also charge interest on all overdue interest for the past three years--including that due under original contracts--this would add another \$300 million. [REDACTED]

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Unless the Paris Club agrees to provide 100 percent debt relief, Warsaw also will have to cover unrescheduled obligations not included in any new agreements. We estimate that principal

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and interest due to Paris Club creditors between 1982 and 1984 under original loan contracts is about \$10 billion. Debt relief on the same terms as the 1981 agreement--rescheduling of 90 percent of both interest and principal--would leave \$1 billion still to be paid. If the creditors reschedule an extra five percent of payments, the downpayment would fall to \$500 million. [redacted]

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If our estimates are accurate, Poland would have \$1-1.2 billion available to pay government creditors this year. This would be enough to:

- cover payments due under the 1981 Paris Club agreement;
- pay interest on overdue interest; and
- make a \$100-300 million downpayment on a further rescheduling agreement, or less than enough for a 10-percent downpayment on a debt relief agreement covering obligations due in 1982.

This also assumes that, unlike the past two years, creditors outside the bank group and the Paris Club would receive no payments. Governments could improve their prospects for being paid only by providing borrowed payment capacity, that is, new credits. The only other alternative would be if the banks, the Paris Club, and the Poles reached an agreement specifying how the creditors would share Poland's limited payment capacity. [redacted]

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Appendix: Discrepancies in Polish Payments Data

A puzzle in Polish foreign trade data in recent years has been the wide discrepancy between data presented on a customs basis and on a payments basis. For example, Poland recorded a trade surplus with the West in 1982 of \$1.47 billion, but was able to convert only \$358 million of the surplus into hard currency payments capacity.

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Last year Warsaw provided data that showed that most of the discrepancy is accounted for by the inability to collect payments for exports and the need to satisfy supplier demands for payment in advance. On the export side, the Poles say that receipts in 1982 were \$743 million less than the value of shipments because:

- \$743 million in exports delivered in 1982 were paid for in 1981;
- \$192 million in export bills were overdue at the end of the year;
- \$47 million in medium- and long-term credits were extended to finance exports; and
- \$411 million represented soft-currency exports for construction projects, probably in LDCs.

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Import payments exceeded the value of deliveries to Poland by \$367 million, mainly because suppliers insisted on advance payments. This figure essentially represents payments made in 1982 for goods which were not received by the end of the year.

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[REDACTED]

Because much of the goods-payments gap is due to lags, the gap should be temporary and should be reversed in Poland's favor when payments catch up with deliveries for both exports and imports. The Poles told government creditors last October that in the first six months of 1983, the gap narrowed to \$237 million. Only about \$100 million of this represented a payments lag, with the remainder accounted for by soft-currency exports. Final data are not available, but preliminary figures indicate that the surplus for all of 1983 on a customs basis was still about \$500 million greater than on a payments basis. [REDACTED]

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We expect further improvement in Warsaw's ability to reap the financial rewards from its trade surplus. Early discussions with bankers this year indicate that Warsaw's primary goal in negotiating debt relief is to gain access to letters of credit that will finance imports at least over the shipping period. [REDACTED]

[REDACTED]

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TABLE 1

Poland: Payment Capacity

	1981	1982	1983 (Preliminary)
TOTAL	<u>4,554</u>	<u>2,430</u>	<u>2,435</u>
Earned	44	760	1,450
Trade	<u>-751</u>	<u>358</u>	<u>950</u>
Exports	--	4,974	5,600
Imports	--	4,616	4,650
Services (excluding interest) and Transfers	795	402	500
Borrowed	<u>4,510</u>	<u>1,670</u>	<u>985</u>
New Credits	<u>4,930</u>	<u>1,474</u>	<u>550</u>
Recycled interest, net	0	196	325
1982 agreement	--	<u>196</u>	<u>178</u>
1983 agreement	--	--	147
Extended, net	-420	-5	110

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TABLE 2

Poland: Balance of Payments Plan for 1984

	Standard	Optimistic	CIA Projection
Total Payments Capacity,	1,750	4,100	2,200-2,400
Earned Payments Capacity	1,550	1,600	1,600
Hard Currency Trade	+1,300	+1,400	1,400
Exports	6,500	7,000	
Imports	5,200	5,600	
Invisibles, net	500	500	500
Other, net	-250	-300	-300
Borrowed Payments Capacity (new credits)	200	2,500	600-800
Allocated to:			
Interest Payments	1,200	2,900	
Principal Payments	550	1,200	

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Results in 1983, Outlook for 1984

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